FEDERAL ELECTION COMMISSION
WASHINGTON, D C. 20463

AUG 2 4 2004

Heartsill Ragon III
5229 Edgewood Road
Little Rock, AR 72207

RE: MUR 5514
Heartsill Ragon III

Dear Mr. Ragon:

On August 12, 2004, the Federal Election Commission found that there is reason to believe you knowingly and willfully violated 2 U.S.C. § 441f, a provision of the Federal Election Campaign Act of 1971, as amended ("the Act"). The Factual and Legal Analysis, which formed a basis for the Commission's finding, is attached for your information.

You may submit any factual or legal materials that you believe are relevant to the Commission's consideration of this matter. Please submit such materials to the General Counsel's Office within 15 days of your receipt of this letter. Where appropriate, statements should be submitted under oath. In the absence of additional information, the Commission may find probable cause to believe that a violation has occurred

Requests for extensions of time will not be routinely granted. Requests must be made in writing at least five days prior to the due date of the response and specific good cause must be demonstrated. In addition, the Office of the General Counsel ordinarily will not give extensions beyond 20 days.

If you intend to be represented by counsel in this matter, please advise the Commission by completing the enclosed form stating the name, address, and telephone number of such counsel, and authorizing such counsel to receive any notifications and other communications from the Commission.

This matter will remain confidential in accordance with 2 U.S.C. §§ 437g(a)(4)(B) and 437g(a)(12)(A), unless you notify the Commission in writing that you wish the investigation to be made public.

For your information, we have enclosed a brief description of the Commission's procedures for handling possible violations of the Act. If you have any questions, please contact Roy Q. Luckett, the attorney assigned to this matter, at (202) 694-1650.

Sincerely,

Bradley A. Smith
Chairman

Enclosures
Factual and Legal Analysis
Procedures
Designation of Counsel Form

FEDERAL ELECTION COMMISSION

FACTUAL AND LEGAL ANALYSIS

RESPONDENT: Heartsill Ragon III MUR 5514

I. GENERATION OF MATTER

This matter was generated based on information ascertained by the Federal Election Commission ("the Commission") in the normal course of carrying out its supervisory responsibilities. *See* 2 U.S.C. § 437g(a)(2).

II. THE APPLICABLE LAW

The Federal Election Campaign Act of 1971, as amended ("the Act") provides that no person shall make a contribution in the name of another person or knowingly permit his or her name to be used to effect such a contribution, and that no person shall knowingly accept a contribution made by one person in the name of another person. 2 U.S.C. § 441f. In addition, no person may knowingly help or assist any person in making a contribution in the name of another. 11 C.F.R. § 110.4(b)(1)(iii).[1] This prohibition also applies to persons or entities who provide money to others to effect contributions made in another's name. 11 C.F.R. § 110.4(b)(2).

[1] This regulation "applies to those who initiate or instigate or have some significant participation in a plan or scheme to make a contribution in the name of another . . ." 54 Fed. Reg. 34,105 (1989). In *Central Bank of Denver v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), the Supreme Court held that private plaintiffs could not maintain an aiding and abetting action under § 10(b) of the Securities and Exchange Act of 1934 or Rule 10b-5 thereunder because the text of section 10(b) did not provide for aiding and abetting liability. This ruling, however, does not affect the validity of 11 C.F.R. § 110.4(b)(1)(iii), which arguably goes beyond the text of 2 U.S.C. § 441f in imposing liability for assisting in making contributions in the name of another. The *Central Bank* opinion did not address an agency's authority to promulgate prophylactic rules, which commonly enlarge the scope of the statute; indeed, the Court upheld the Security and Exchange Commission's authority to promulgate such a rule in a post-*Central Bank* decision. *U.S v O'Hagan*, 521 U S. 642, 673 (1997). Imposing liability on those who assist in making contributions in the name of another through 11 C.F.R. § 110.4(b)(1)(iii) also serves a prophylactic purpose.

The Act penalizes more heavily violations that are knowing and willful. 2 U.S.C. §§ 437g(a)(5)(B), (6)(c), and (d)(1). To be liable for a knowing and willful violation, respondents must act with the knowledge that they are violating the law. *Federal Election Commission v. John A. Dramesi for Congress Committee,* 640 F. Supp. 985, 987 (D.N.J. 1986). An inference of a knowing and willful act may be drawn "from the defendant's elaborate scheme for disguising" his or her actions. *United States v. Hopkins,* 916 F.2d 207, 214-15 (5th Cir. 1990).

III. FACTS AND ANALYSIS

A. Shelly Davis' Memorandum

Information in the Commission's possession alleges that CWS may have reimbursed campaign contributions to multiple federal campaigns through company payments of fraudulent invoices, or other reimbursement vehicles, to conduits who were outside vendors to CWS. According to a December 3, 2002 memorandum to CWS board members from Shelly Davis, administrative assistant to former Community Water System, Inc. ("CWS") General Manager Greg Smith, Ms. Davis notes that she became aware of alleged political contribution reimbursements in 1998:

Ms. Davis' memorandum further maintains that the reimbursement scheme continued in 2000. She states that Preston Bynum allegedly called Greg Smith again in order to set up a fundraiser for Congressman Berry in September. According to Ms. Davis, "Once again Greg made his phone calls and instructed the individuals to handle as before."

Although Ms. Davis' memorandum refers generally to multiple individuals who were instructed to contribute with the expectation of reimbursement, she identified by full name only attorney Heartsill Ragon III of Gill Elrod Ragon Owen & Sherman P.A. ("Gill Law Firm"), who provided legal services to CWS.[3] An October 29, 2000 invoice, on Gill Law Firm letterhead, to CWS contains a "miscellaneous" expense on October 11, 2000 in the amount of $1,000.[4]

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[2] According to published accounts, in 1998 CWS General Manager Greg Smith hired Preston Bynum, a recently released felon convicted of bribery and perjury charges, as a lobbyist to help CWS secure federal and state funding for the Lonoke-White Project. *See* Elisa Crouch, *Waterline Project Beset by Conflicts over Management*, The Arkansas Democrat Gazette, March 2, 2003. The Lonoke-White Project is a pipeline expected to pump water from Greers Ferry Lake to six water systems in Lonoke and White counties in Arkansas, reaching more than 16,000 customers. *Id.*

[3] According to Dun and Bradstreet reports, the Gill Law Firm has been incorporated since 1994. Heartsill Ragon III is listed as a Vice President of the firm.

[4] Ms. Davis' memorandum appears to state that the "miscellaneous" expense was $2,000. However, the invoice is for only $1,000.

According to Ms. Davis' memorandum, Greg Smith allegedly instructed CWS's controller to refrain from paying the invoice until the expense was identified. A CWS employee allegedly contacted the Gill Law Firm and was informed by Mr. Ragon that the "miscellaneous" expense represented reimbursement of a political contribution. Mr. Ragon reportedly also stated that Mr. Smith had instructed him to classify the political contribution reimbursement as "miscellaneous."[5] The Commission's copy of the October 29, 2000 invoice is accompanied by handwritten notes, appearing on the right side, reportedly reading "Political contribution. Greg told Heartsill to charge it."[6] Ms. Davis' memorandum states that "[t]hese contributions are being made, the invoices submitted for payment. Greg approves them for payment out of Federal Grant Funds and then he collects 3% of the expense."[7]

According to Ms. Davis' memorandum, CWS engaged in political contribution reimbursement activity in 2002 in connection with an August 9, 2002 fundraiser for Congressman Berry and an August 15, 2002 fundraiser for Senator Hutchinson. CWS allegedly reimbursed Heartsill Ragon III for contributions made to the campaigns of Congressman Berry

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[5] Ms. Davis suggests in her memorandum that Mr. Ragon spoke to CWS employee Jennifer Fife directly, but Ms. Fife's recollection, as reported in the press, was that she spoke to Mr. Ragon's secretary. *See* Elisa Crouch, *Waterline Project Beset by Conflicts over Management,* The Arkansas Democrat Gazette, March 2, 2003.

[6] Although the handwritten notes are not clearly visible, the CWS employee who contacted Mr. Ragon's office reportedly identified the handwriting as her own, and described the content of her notes in a press interview. *See* Elisa Crouch, *Waterline Project Beset by Conflicts over Management,* The Arkansas Democrat Gazette, March 2, 2003.

[7] Elsewhere in Ms. Davis' memorandum, she alleges that Economic Development of Arkansas Fund Commission ("EDAFC") grant funds were used to pay fraudulent expenses. It is possible that EDAFC had a funding arrangement with the federal government. According to published reports, the EDAFC awarded funds to the Lonoke-White Project, which would in turn distribute funds to CWS. *See* Sonja Oliver, *CWS audit report,* Fairfield Bay News, March 12, 2003. CWS would acquire the EDAFC funds as a reimbursement for expenses paid by CWS's own operating funds. *Id.* Additionally, according to published reports, in 1999 Greg Smith formed Cenark Project Management Services Inc. ("Cenark"), a corporation that CWS hired to manage the Lonoke-White Project. *Id.* According to the terms of the contract between CWS and Cenark, Cenark received 3 % of the cost of the Lonoke-White Project as its fee for management services on behalf of CWS. *Id.* Therefore, if CWS reimbursed political contributions, and these were reflected as costs of the Lonoke-White Project, CWS would be reimbursed by grant funds and Cenark would receive 3% of the costs of the project.

and Senator Hutchinson. Ms. Davis states that Mr. Smith requested that Mr. Ragon send his invoices before the contributions were actually made:

The Commission also possesses a copy and a "corrected" copy of Gill Law Firm invoices dated July 29, 2002 and an invoice purportedly revised dated August 29, 2002. The original July 29, 2002 invoice includes an entry for $2,000 described as "miscellaneous reimbursements." The "corrected" July 29, 2002 invoice reflects a change in the description of the $2,000 in expenses from "miscellaneous reimbursements" to "series of intraoffice conferences re: various long-term planning, finance and operational issues."[8] The August 29, 2002 invoice has an entry for 15.40 hours of legal services for "series of intraoffice conferences re: various long-term planning, finance and operational issues."[9] At an indicated rate of $130 per hour, this entry represents a request by the Gill Law Firm for payment of $2,002.

According to Ms. Davis, Mr. Smith had directed Heartsill Ragon III to change the descriptions in the invoices. In her memorandum, Ms. Davis recounts Mr. Smith's alleged discussion with Mr. Ragon about revising the invoices:

[8] Although the Commission does not know the actual date that the amended invoice was submitted, the written notes (author unknown) on the invoice suggest that CWS received it on October 2, 2002.

[9] Information in the Commission's possession does not include a prior August 2002 invoice with the entry "miscellaneous reimbursements."

Thereafter, Ms. Davis describes her efforts to gather additional evidence of the alleged reimbursement scheme. Ms. Davis states that while Mr. Smith was out of the office, she e-mailed Mr. Ragon and requested that he refax the invoices to her and he did so.

Mr. Ragon's response to Ms. Davis's e-mail, which the Commission possesses, states "Shelly, thanks for the note. I'll refax. I've taken out the 'extra' $1,000 charge. Thanks...H."

The Commission is also in possession of a December 4, 2002 e-mail from Ms. Davis, which appears to be directed to CWS board member Barbara Sullivan.[10] Ms. Davis eventually confronted Mr. Smith regarding the alleged conduit contribution scheme, stating:

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It is possible that Ms. Davis' alleged confrontation with Mr. Smith led him to contact the Gill Law Firm concerning her allegations. A November 21, 2002 memorandum from Heartsill Ragon III to Greg Smith addresses the Gill Law Firm's refund of $4,002 in legal fees included in its July and August 2002 invoices, and suggests that questions had been raised about the services noted in these invoices.

In December 2002, CWS reportedly dismissed Greg Smith and terminated its working relationship with the Gill Law Firm, reportedly noting in a file memorandum that Mr. Smith's activities on behalf of CWS appeared to involve illegal contributions to political candidates and the falsification of records.[11] Further, CWS board member Barbara Sullivan has stated in press accounts that she expects the full scope of the reimbursement scheme to reach at least $20,000 in reimbursed contributions. *See* Bert King, *Water Chief Fired Due to Dereliction,* The Cabot Star Herald, January 8, 2003. Both Mr. Smith and the Gill Law Firm reportedly have maintained their innocence; Mr. Smith and CWS currently are embroiled in two separate lawsuits (wrongful

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[11] *See* Christine Weiss, *CWS memo cites 'illegal acts' leading to firing,* The Heber Springs Sun-Times, January 3, 2003.

termination and breach of contract) growing out of the allegations in this matter.[12]

B. Analysis

FEC disclosure records indicate that Gill Law Firm attorney Heartsill Ragon III, as well as other Gill Law Firm attorneys Charles C. Owen and Chris Travis, made contributions to Marion Berry for Congress and Tim Hutchinson for Senate in August 2002, collectively totaling $4,000.[13] These contributions are consistent with Ms. Davis' allegation that Greg Smith instructed Mr. Ragon on July 15, 2002 to submit invoices totaling $4,000 for reimbursements of political contributions. Further, it appears that the Gill Law Firm's July and August 2002 invoices were the mechanisms by which the Gill Law Firm attorneys, including Mr. Ragon, may have been reimbursed for their respective contributions. As discussed previously, the Gill Law Firm's original July 29, 2002 invoice that describes a $2,000 expense as "miscellaneous reimbursements" was allegedly "corrected," on Greg Smith's instructions, to read "series of intraoffice conferences re: various long-term planning, finance and operational issues." Although the Gill Law Firm August 29, 2002 invoice does not include a similar "miscellaneous reimbursements" entry, Ms. Davis' memorandum suggests that a prior copy may have contained such language.

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12 *See* Sonja Oliver, *CWS board still facing lawsuits*, The Heber Springs Sun-Times, December 24, 2003. In February 2003, following Smith's termination, CWS reportedly dissolved its contract with Cenark. *See* Michelle Hillen, *Lawsuits fly: Fired utility chief, water system toe-to-toe Pipeline conflict of interest cited*, The Arkansas Democrat Gazette, July 1, 2003 Mr. Smith reportedly lost approximately $1.3 million in Cenark fees due to the contract dissolution. *Id.* On December 23, 2003, citing breach of contract, Cenark reportedly sued CWS for "$1.2 million-plus." *See* Randy Kemp, *Smith sues CWS for $1.2 million,* The Heber Springs Sun-Times, January 30, 2004.

13 Mr. Ragon is reported as contributing $1,000 to each committee; Mr. Travis is reported as contributing $1,000 to the Berry committee; and Mr. Owen is reported as contributing $1,000 to the Hutchinson committee.

As discussed *supra*, knowing and willful activity can be shown by an elaborate scheme to disguise corporate political contributions. *See United States v. Hopkins,* 916 F.2d 207, 214-15 (5th Cir. 1990). Ms. Davis alleges that Greg Smith instructed Heartsill Ragon III to submit false invoices to CWS to collect reimbursement for making contributions to federal candidates, and that he did so. This allegation, if proven, would represent an elaborate scheme to disguise corporate reimbursements of political contributions.

Therefore, there is reason to believe that Heartsill Ragon III knowingly and willfully violated 2 U.S.C. § 441f.